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BEFORE THE ARIZONA CORPORATION COMMISSION

Marc Spitzer  
Chairman  
Jim Irvin  
Commissioner  
William A. Mundell  
Commissioner  
Mike Gleason  
Commissioner  
Jeff Hatch-Miller  
Commissioner

ORIGINAL  
Arizona Corporation Commission  
DOCKETED

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ARIZONA CORPORATION COMMISSION  
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IN THE MATTER OF THE APPLICATION OF  
ARIZONA WATER COMPANY, AN  
ARIZONA CORPORATION, FOR ADJUST-  
MENTS TO ITS RATES AND CHARGES FOR  
UTILITY SERVICE FURNISHED BY ITS  
NORTHERN GROUP AND FOR CERTAIN  
RELATED APPROVALS.

DOCKET NO.  
W-01445A-00-0962

**AUIA'S POST-HEARING BRIEF**

Pursuant to the direction of the Administrative Law Judge at the close of hearing on June 26, 2003, the ARIZONA UTILITY INVESTORS ASSOCIATION, INC. (AUIA) hereby submits its post-hearing brief in the above captioned matter.

**Introduction**

At an Open Meeting held on April 22, 2003, the Arizona Corporation Commission considered a Recommended Order and Opinion (ROO) in Phase 2 of this proceeding. However, the Commission remanded this matter to the Hearing Division to take further evidence regarding potential leasing options for arsenic treatment facilities. Thereafter, the Administrative Law Judge (ALJ) ordered the parties to conduct settlement discussions and scheduled a hearing to begin on June 26, 2003.

The issues in the settlement discussions boiled down to two: 1) whether some portion of arsenic-related O&M could be recovered through an arsenic cost recovery mechanism (ACRM); and 2) how lease costs would be treated under the ACRM.

**O&M Recovery, Build-to-own Scenario**

Arizona Water Company (AWC), Staff and AUIA submitted pre-filed testimony regarding the inclusion of O&M in the ACRM.

1 RUCO took the position that O&M recovery had been excluded from the ACRM in  
2 the ROO and was not eligible for reconsideration.<sup>1</sup>

3 Staff and AWC concluded that inclusion of at least some O&M recovery is  
4 necessary to achieve the financial purpose of the ACRM.<sup>2</sup> In fact staff witness Ralph  
5 Kennedy testified that the company's financial position could be damaged severely  
6 without O&M recovery and it would be "reckless" to exclude it.<sup>3</sup>

7 AWC proposed that three specific operating costs be recoverable through the  
8 ACRM in a build-to-own scenario. The three costs are: 1) media replacement or  
9 regeneration; 2) media replacement service; and 3) media waste disposal.<sup>4</sup> AWC  
10 asserted that these costs could be easily identified and would be passed directly  
11 through with no mark-up and no effect on company earnings.<sup>5</sup>

12 Staff concurred with the AWC proposal and labeled the three items  
13 "recoverable O&M" under the ACRM, while emphasizing that no other O&M  
14 should be recoverable.<sup>6</sup>

15 AUIA also concurred with this treatment of O&M in the build-to-own  
16 scenario.<sup>7</sup>

17 **Leasing: The Least Cost Option**

18 In direct testimony, Commission Staff simply extended its proposed  
19 treatment of "recoverable O&M" to lease arrangements. That is, when the ACRM is  
20 applied to a lease agreement, AWC would be allowed to recover its capital costs and  
21 the three specific operating costs cited above, but no other O&M.<sup>8</sup> This would  
22 require a potential lessor to partition its lease proposal so that the individual cost  
23 elements could be identified.<sup>9</sup>

24 However, on cross-examination, both staff witness Gordon Fox and Mr.  
25 Kennedy testified that they had no idea whether potential lessors would be willing  
26 to disclose the details of their proposals.<sup>10</sup>

27 Nevertheless, in pre-filed testimony, AWC agreed with this approach. In  
28 fact, Mr. Kennedy testified that AWC would disqualify any potential lessor that was  
29 unwilling to reveal the details required by the Staff approach.<sup>11</sup>

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<sup>1</sup> Ex. R-2, P. 6, L. 2-7

<sup>2</sup> Ex. A-3, P. 5, L. 22 - P. 6, L. 2 and Ex. S-8, P. 2, L. 20-21

<sup>3</sup> Tr., P. 369, L. 12-25

<sup>4</sup> Ex. A-3, P. 26 - P. 7, L. 6

<sup>5</sup> Ex. A-3, P. 7, L. 5-13 and Tr., P. 363, L. 14 - P. 364, L. 6

<sup>6</sup> Ex. S-8, P. 3, L. 2-11

<sup>7</sup> Ex. AUIA-1, P. 3, L. 21-33

<sup>8</sup> Ex. S-8, P. 3, L. 3-7

<sup>9</sup> Ex. S-8, P. 5, L. 8-17

<sup>10</sup> Tr., P. 368, L. 1-5 and Tr., P. 392, L. 6-9

<sup>11</sup> Ex. A-3, P. 7, L. 18-26 and Tr., P. 365, L. 2 - P. 366, L. 5

1 On cross-examination, Mr. Kennedy conceded that such a requirement, if  
2 rejected by potential lessors, could thwart leasing and expose AWC customers to  
3 higher arsenic treatment costs.<sup>12</sup> Likewise, when asked whether the Staff's  
4 approach might deny customers a least-cost solution to arsenic treatment, Mr. Fox  
5 also admitted that this was possible.<sup>13</sup>

6 Mr. Kennedy was asked why it should be necessary to break apart the  
7 components of a lease agreement that is negotiated at arms' length and is clearly the  
8 least cost option. He responded that it should not be necessary and that the full lease  
9 cost should be recoverable, but that AWC had accepted the Staff's methodology.<sup>14</sup>

10 Mr. Kennedy also testified regarding his contacts with the Water  
11 Infrastructure Financing Agency (WIFA) regarding arsenic treatment costs.<sup>15</sup> When  
12 asked whether WIFA would be likely to fund arsenic treatment equipment if O&M  
13 costs aren't recoverable, Mr. Kennedy said, "No."<sup>16</sup>

14 Assuming that leasing could be the least-cost option for many water  
15 companies, AUIA argued that the full cost of a lease that has been negotiated at  
16 arms' length should be recoverable through the ACRM.<sup>17</sup> Such a pass-through  
17 would have no effect on the company's earnings.

#### 18 Conclusion

19 In dealing with the new federally-imposed arsenic standard, the Arizona  
20 Corporation Commission has two objectives: 1) To ensure that water providers  
21 under its jurisdiction do meet the standard; and 2) To enable compliance at the least  
22 possible cost to consumers.

23 At the Open Meeting on April 22, 2003, Commissioners expressed the hope  
24 that the resolution of arsenic cost recovery in this case would provide a "template"  
25 for dealing with other water systems that must perform arsenic mitigation.

26 Based on the evidence in this docket, it is very likely that some water  
27 companies will be unable to finance the improvements needed to reduce arsenic  
28 levels if they cannot recover all or most of their O&M costs. Because we recognize  
29 that there are potential earnings issues related to O&M recovery in a build-to-own  
30 scenario, AUIA urges the Commission to adopt the limited three-part recoverable  
31 O&M for the ACRM in that scenario.

32 However, the evidence in this docket also indicates that lease agreements  
33 may be the most viable and least-cost option, especially in the early years of  
34 compliance. If a lease is negotiated at arms' length and if it is demonstrated to be

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<sup>12</sup> Tr., P. 366, L. 17 - P. 367, L. 1

<sup>13</sup> Tr., P. 392, L. 10-13

<sup>14</sup> Tr., P. 366, L. 6-16 and Tr., P. 367, L. 9-17

<sup>15</sup> Tr., P. 368, L. 7 - P. 369, L. 5

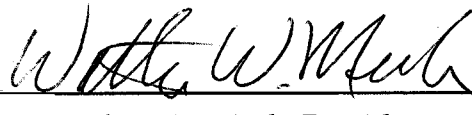
<sup>16</sup> Tr., P. 370, L. 1-6

<sup>17</sup> Ex. AUIA-1, P. 5, L. 1-11

1 the least-cost option, the Commission should allow the full cost of the lease to be  
2 recovered in the ACRM.

3 In this proceeding, Staff has not demonstrated a compelling need to require  
4 potential lessors to expose the internal elements of their leases. Instead, they have  
5 proffered the vague theory that cost recovery in either scenario must be  
6 comparable. AUIA fails to see how this theory advances the interest of consumers  
7 who want safe drinking water at the least possible cost and we urge the  
8 Commission not to erect barriers that could discourage lease agreements and deny  
9 consumers a least-cost solution.

10  
11 Respectfully submitted this 15<sup>th</sup> day of August, 2003.

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15 Walter W. Meek, President  
16

1                   **CERTIFICATE OF SERVICE**

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3                   An original and 13 copies of the referenced  
4                   brief were filed this 15<sup>th</sup> day of August, 2003, with:

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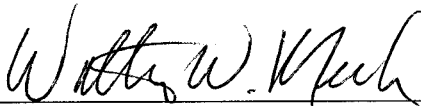
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